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Montana State Lottery audited financial statements

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MONTANA STATE LOTTERY

AUDITED FINANCIAL STATEMENTS

June 30, 1990

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MONTANA STATE LOTTERY

AUDITED FINANCIAL STATEMENTS

June 30, 1990

JUNKERMIER, CLARK, CAMPANELLA, STEVENS P.C.
Certified Public Accountants

MONTANA STATE LOTTERY
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STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122

LEGISLATIVE AUDITOR:
SCOTT A. SEACAT

LEGAL COUNSEL:
JOHN W. NORTHEY

DEPUTY LEGISLATIVE AUDITORS:
MARY BRYSON
Operations and EDP Audit
JAMES GILLETT
Financial-Compliance Audit
JIM PELLEGRINI
Performance Audit

October 1990

The Legislative Audit Committee
of the Montana State Legislature:

Enclosed is the report on the audit of the Montana State Lottery for the fiscal year ended June 30, 1990.

The audit was conducted by Junkermier, Clark, Campanella, Stevens P.C. under a contract between the firm and our office. The comments contained in this report represent the views of the firm and not necessarily the Legislative Auditor.

Respectfully submitted,

Scott A. Seacat
Legislative Auditor

MONTANA STATE LOTTERY
Commission Members and Administrative Officials
June 30, 1989

Commission Members	Residence
Pat DeVries, Chairwomen	Polson
Rebecca Erickson	Glasgow
William Ware	Helena
Gary Rebal	Great Falls
Ward Shanahan	Helena

Administrative Officials

Zoann Attwood, Director

L. John Onstad, Security

Gerald J. LaChere, Operations

Janet Drexel, Marketing

MONTANA STATE LOTTERY
INTRODUCTIONS AND BACKGROUND
June 30, 1990

INTRODUCTION

We performed a financial-compliance audit of the Montana State Lottery for the fiscal year ended June 30, 1990, and issued an opinion on such. The scope of our services is defined in our contract with the Office of Legislative Auditor, as supplemented by certain requirements included in the bidders information.

As a result of our audit, we have issued a independent auditors' report on compliance with laws and regulations and internal control structure related matters which includes certain required comments.

BACKGROUND

The Montana State Lottery was created in November 1986 by a referendum vote of the people of Montana. The "Montana State Lottery Act of 1985" appears as Chapter 669 of the 1985 Montana Session Laws. The general purpose is to allow lottery games in which the players purchase from the state, through the administration of the Montana State Lottery, a chance to win a prize. Disposition of revenue is a minimum of 45% for prizes, a minimum of 5% for commissions to sales agents, payment of operating expenses, and the remaining revenue to the Superintendent of Public Instruction.

Junkermier · Clark
Campanella · Stevens · P.C.

Certified Public Accountants

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Walter J. Kero, CPA

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS BASED ON THE AUDIT OF MONTANA STATE LOTTERY FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS ISSUED BY THE GAO

Commissioners
Montana State Lottery
Helena, Montana

We have audited the financial statements of Montana State Lottery as of and for the year ended June 30, 1990, and have issued our report thereon dated September 7, 1990.

We conducted our audit in accordance with generally accepted auditing standards, Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with State and Federal statutes and regulations applicable to the Montana State Lottery is the responsibility of the Lottery's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the Montana State Lottery's compliance with certain provisions applicable to State and Federal statutes and regulations. However, it should be noted that our objective was not to provide an opinion on overall compliance with such provisions.

The results of our tests indicate that, with respect to the items tested, the Montana State Lottery complied, in all material respects, with the provisions referred to in the preceding paragraph. With respect to items not tested nothing came to our attention that caused us to believe that the Montana State Lottery had not complied, in all material respects, with those provisions.

This report is intended for the information of management and legislative audit committee. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Junkermier, Clark, Campanella, Stevens, PC

Helena, Montana
September 7, 1990

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Campanella · Stevens · P.C.

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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL STRUCTURE RELATED MATTERS NOTED IN THE MONTANA STATE LOTTERY FINANCIAL STATEMENT AUDIT CONDUCTED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Commissioners
Montana State Lottery
Helena, Montana

We have audited the financial statements of Montana State Lottery for the year ended June 30, 1990, and have issued our report dated September 7, 1990.

We conducted our audit in accordance with generally accepted auditing standards, Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In planning and performing our audit of the financial statements of Montana State Lottery for the year ended June 30, 1990, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure.

The management of Montana State Lottery is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories:

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INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL STRUCTURE RELATED MATTERS NOTED IN THE MONTANA STATE LOTTERY FINANCIAL STATEMENT AUDIT CONDUCTED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Cash receipts/receivables/revenue
Program fund expenditures/assets/payables/expenses
Payroll/related liabilities
Fixed assets depreciation/intangibles amortization

For all of the control categories listed above, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a reportable condition in which the design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the general purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control structure and its operation that we consider to be material weaknesses as defined above.

The following is a summary of actions taken by the Lottery on reportable conditions and recommendations in the prior year's report (June 30, 1989):

RECOMMENDATION:

We recommend that the Montana State Lottery develop accounting policy and procedure manual.

ACTION:

The Lottery is actively developing accounting policies and procedures documents to reduce to writing the policies and procedures that are in place. The documents are in different stages of completion.

This report is intended for the information of management, and legislative audit committee. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

Junkermier, Clark, Campanella, Stevens, PC

Helena, Montana
September 7, 1990

Junkermier · Clark
Campanella · Stevens · P.C.

Certified Public Accountants

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INDEPENDENT AUDITORS' REPORT

Commissioners
Montana State Lottery
Helena, Montana

We have audited the accompanying balance sheets of Montana State Lottery as of June 30, 1990, and 1989, and the related statements of revenue, expense, and changes in retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Lottery's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Montana State Lottery as of June 30, 1990, and 1989, and the results of its operations, and cash flows for the year then ended in conformity with generally accepted accounting principles.

Junkermier, Clark, Campanella, Stevens, PC

Helena, Montana
September 7, 1990

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MONTANA STATE LOTTERY
BALANCE SHEETS

ASSETS

	June 30 1990	June 30 1989
CURRENT ASSETS		
Cash and cash equivalents	$1,341,235	$ 786,702
Accounts receivable	771,995	664,497
Inventory	108,456	133,974
Prepaid expenses	1,928	1,338
Employee advances	5,940	5,000
	2,229,554	1,591,511
FIXED ASSETS		
Computer, furniture and equipment	772,183	737,014
Computer software	840,400	840,400
	1,612,583	1,577,414
Less: accumulated depreciation and amortization	(846,062)	(577,866)
	766,521	999,548
OTHER ASSETS		
Advertising license fee, net of accumulated amortization of $47,857 in 1990 and $11,209 in 1989	52,143	88,791
	$3,048,218	$2,679,850

LIABILITIES AND FUND EQUITY

CURRENT LIABILITIES		
Long-term debt due within one year	$ 165,284	$ 189,204
Accounts payable and accruals	329,526	85,663
Due to State Superintendent of Public Instruction	1,519,520	306,410
Due to other state agencies	76,430	65,422
Accrued compensated absences	94,392	74,789
Estimated prizes payable	695,144	1,505,143
Deferred on-line revenue	20,029	-
Allowance for ticket returns	147,893	287,964
	3,048,218	2,514,595
LONG-TERM DEBT, net of current portion	-	165,284
FUND EQUITY (DEFICIT)		
Unreserved retained earnings (deficit)	-	(29)
	$3,048,218	$2,679,850

See the accompanying independent auditors' report and the notes to financial statements.

MONTANA STATE LOTTERY
STATEMENTS OF REVENUE, EXPENSE AND CHANGES IN RETAINED EARNINGS

	Years ended June 30	
	1990	1989
OPERATING REVENUE		
Instant ticket games	$11,619,715	$11,644,061
On-line games	9,890,070	-
License fees	4,157	3,600
	21,513,935	11,647,661
OPERATING EXPENSE		
Prizes - instant ticket games	5,549,622	5,300,097
Prizes - on-line games	4,639,706	-
Retailer commissions	1,352,477	669,313
Cost of instant tickets sold	552,884	630,843
On-line vendor fees	2,358,147	-
Personal services	919,490	905,375
Contracted services	364,667	272,668
Advertising	779,968	231,536
Amortization	204,747	179,289
Depreciation	118,258	114,994
Supplies and materials	103,051	71,589
Rent and utilities	95,280	93,969
Communications	67,710	64,193
Travel	41,706	35,877
Repairs and maintenance	83,709	76,313
Management service fees	78,172	71,446
On-line operating fees	25,788	-
Other	29,964	15,148
	17,365,346	8,732,650
NET OPERATING INCOME BEFORE NONOPERATING EXPENSE AND TRANSFERS	4,148,589	2,915,011
NONOPERATING REVENUE (EXPENSE)		
Interest income	25,825	-
Interest expense	(540)	(913)
Loss on sale of fixed assets	(4,987)	-
Operating transfers to State Superintendent of Public Instruction	(4,168,858)	(2,774,692)
NET INCOME	29	139,406
Reserved (unreserved) retained earnings (deficit) at beginning of year	(29)	(139,435)
RESERVED (UNRESERVED) RETAINED EARNINGS (DEFICIT) AT END OF YEAR	$ -	$ (29)

See the accompanying independent auditors' report and the notes to financial statements.

MONTANA STATE LOTTERY
STATEMENTS OF CASH FLOWS

	Years ended June 30	
	1990	1989
CASH FLOWS FROM OPERATING ACTIVITIES		
Net operating income before nonoperating expense and transfers	$ 4,148,589	$ 2,915,011
Adjustment to reconcile net operating income to net cash provided by operating activities:		
Amortization and depreciation	323,005	294,283
Decrease (Increase) in:		
Accounts receivable	(107,498)	(442,197)
Inventory	25,518	65,243
Prepaid expenses	(590)	20,760
Employee advances	(940)	50
Increase (Decrease) in:		
Accounts payable and accruals	243,863	35,011
Due to other state agencies	11,008	(23,514)
Accrued compensated absences	19,603	84
Estimated prizes payable	(809,999)	(1,870,272)
Deferred on-line revenue	20,029	-
Allowance for returned tickets	(140,071)	(3,456)
	3,732,517	991,003
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Operating transfers out to State Superintendent of Public Instruction	(2,955,748)	(3,700,759)
Acquisition of advertising license fee	-	(100,000)
	(2,955,748)	(3,800,759)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Payment of long-term debt	(189,204)	(188,830)
Acquisition of fixed assets	(66,033)	(2,250)
Proceeds from sale of fixed assets	7,716	-
Interest paid on fixed assets acquisition contract	(540)	(913)
	(248,061)	(191,993)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest earned on cash equivalents	25,825	-
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	554,533	(3,001,749)
Cash and cash equivalents at beginning of year	786,702	3,788,451
CASH AND CASH EQUIVALENTS AT YEAR END	$ 1,341,235	$ 786,702

See the accompanying independent auditors' report and the notes to financial statements.

MONTANA STATE LOTTERY
NOTES TO FINANCIAL STATEMENTS
June 30, 1990 and 1989

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization:

The Montana State Lottery was created in November 1986 by a referendum vote of the people of Montana. Section 23-5-1001, Montana Code Annotated (MCA) establishes the provision of the code under which the Montana State Lottery operates. The Montana Lottery is operated by a five member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the types and forms of lottery games, set the ticket price, number and size of prizes, conduct lottery drawings, enter into agreements to offer regional lottery games and prepare financial reports.

Disposition of revenue is a minimum of 45% for prizes, a minimum of 5% for commissions to sales agent, payment of operating expenses and the remaining revenue to the State Superintendent of Public Instruction.

The State of Montana provides certain services to the Lottery covering: central payroll, accounting, self-insurance, communication, motor pool and various other services. The costs charged to the Lottery for these services, approximately $1,265,000 and $1,140,000 in fiscal years ended June 30, 1990, and 1989, respectively.

Reporting Entity:

The Lottery, a division within the Montana Department of Commerce, is considered a component unit of the oversight unit known as the State of Montana. There are no component units to be included with the Lottery as a reporting agency.

Basis of Accounting:

The Lottery utilizes the accrual basis of accounting and is classified as an enterprise fund of the governmental proprietary fund type. Enterprise funds account for operations: a) financed and operated similar to private business enterprises, where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or b) where the Legislature has decided that periodic determination of revenue earned, expenses incurred or net income is appropriate.

Revenue Recognition:

Sales of lottery instant tickets are made to licensed retailers, who in turn sell the tickets to the public. Retailers receive a minimum 5% commission. Revenue is recognized when the tickets are delivered to the retailers. Tickets not sold by the retailer may be returned to the Lottery for credit. Sales are reduced for estimated ticket returns.

Sales of on-line lottery tickets, starting in early November, 1989, are made by licensed retailers to the public with the use of computerized terminals. Retailers receive a 5% commission. Revenue is recognized on the biweekly drawing dates. Tickets sold in advance for future drawing are recorded as deferred revenue until the ticket becomes valid for a drawing.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Prizes:
Prize expense is recognized based on the predetermined prize structure for each instant ticket and on-line game. Free tickets are recorded as a reduction in revenue and not as prize expense.

Cash Equivalents:
Cash equivalents consists of interest-bearing deposits with the Montana Board of Investments in the State's short-term investment pool and cash on deposit with the State Treasurer which is part of the State's pooled cash. These funds are highly liquid and may be drawn on daily.

Inventory:
Inventories consist of tickets and supplies. Ticket inventory includes lottery instant tickets stored in the warehouse and with marketing representatives. The tickets are carried at cost using the specific identification method. Tickets are charged to cost of sales when sold and unsold tickets are charged to cost of sales upon the end or cancellation of a game.

Supply inventory is carried at cost and expensed as used.

Fixed Assets:
Fixed assets are recorded at cost and depreciation or amortization is computed using the straight-line basis over the following estimated useful lives:

Computer	6 years
Software	5 years
Vehicles	4 years
Furniture and equipment	6 - 10 years

Advertising License Fee:
Advertising license fee is recorded at cost and amortization is computed using the straight-line basis over a 3-year estimated useful life.

Accounts Receivable:
Accounts receivable represent amounts due the Lottery for purchased tickets. These amounts are electronically transferred within 28 to 34 days of instant tickets purchased, and weekly for on-line tickets purchased. The Lottery grants credit to licensed retailers throughout the State of Montana. Bad debts are nominal and no allowance for doubtful accounts has been established.

Compensated Absences:
State employees earn vacation leave ranging from 15 to 24 days per year depending on the individuals years of service. Vacation leave may be accumulated to not exceed 2 times the maximum annual leave. Sick leave is earned at 12 days a year with no maximum accumulation. Upon retirement or termination, an employee is paid 100% for unused vacation and 25% for unused sick leave.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Change in Presentation:
The June 30, 1990, financial statements include a statement of cash flows showing cash and cash equivalents provided and used by operating, investing and financing activities in place of a statement of changes in financial position as presented in prior years. June 30, 1989, financial statements have been restated to conform with current presentation.

2. CASH AND CASH EQUIVALENTS

Cash is as follows:

	June 30 1990	June 30 1989
Cash on deposit with State Treasurer	$ 506,585	$ 776,552
Cash on deposit in short term investment pool	824,500	-
Cash in revolving check account	10,000	10,000
Petty cash	150	150
	$1,341,235	$ 786,702

Cash on deposit with State Treasurer and investment pool is part of pooled cash which is not separately identifiable as to specific types of securities. See the statewide audit for the level of risk associated with the cash and cash equivalents.

3. LONG-TERM DEBTS

Long-term debts consist of the following:

	June 30 1990	June 30 1989
Installment purchase of Instant Lottery System software payable in monthly payments of $11,672 including no interest through March 1990 and $23,344 including no interest through February, 1991.	$ 163,411	$ 350,167
Lease purchase of copier payable in monthly payments of $249 including interest at 16.7% through February, 1991.	1,873	4,321
	165,284	354,488
Less portion due within one year	165,284	189,204
Long-term portion	$ -	$ 165,284

4. OBLIGATION TO TRANSFER FUNDS TO STATE SUPERINTENDENT OF PUBLIC INSTRUCTION

The remaining portion of gross revenue not used for payment of prizes, commissions, and operating expenses is transferred quarterly from the Lottery to the State Superintendent of Public Instruction. At June 30, 1990 and 1989, $1,519,520 and $306,410, respectively, were payable to the State Superintendent of Public

4. OBLIGATION TO TRANSFER FUNDS TO STATE SUPERINTENDENT OF PUBLIC INSTRUCTION (Continued)

Instruction. Operating transfers of $4,168,858 and $2,774,692 were reported during the fiscal year ended June 30, 1990 and 1989, respectively.

5. LEASE COMMITMENTS

The Lottery has a lease for office and warehouse space in Helena, Montana. Lease expense included in the operating expenses is $81,600 for the fiscal year ended June 30, 1990, and 1989. Minimum future lease payments, under all non-cancellable leases, are as follows:

Fiscal Years Ended June 30	
1991	$ 81,600
1992	54,400
	$ 136,000

6. EMPLOYEE RETIREMENT SYSTEM

The Lottery and its employees make contributions to the Montana Public Employees Retirement System (PERS) defined benefit plan. The Lottery is required to contribute for full time employees at the rate of 6.417% of annual compensation under state statute. Employees are required to contribute 6% of annual compensation. Part-time employees have an option to belong to the retirement plan, depending upon hours worked. The Montana Public Employees' Retirement System does not segregate financial information for each participating entity.

The total number of Lottery employees covered during the year ended June 30, 1990 and 1989 was 37 and 31, respectively. The total payroll for the employees was $739,699 in 1990, and $730,400 in 1989. The Lottery's contributions were $44,919 and $46,870 for the years ended June 30, 1990, and 1989. Benefit eligibility is age 60 with at least 5 years of service; age 65 regardless of service; or 30 years of service regardless of age. Actuarially reduced benefits may be taken with 25 years of service or at age 50 with at least 5 years of service. Monthly retirement benefits are determined by taking 1/60 times the number of years of service times the final average salary. Members' rights become vested after 5 years of service.

The "pension benefit obligation" is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee service to date. The measure, which is the actuarial present value of credited projected benefits, is intended to help users assess the system's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due and make comparisons among employers. The Lottery is unable to determine the actuarial present value of credited projected benefits and net assets available for benefits since the information is available only on a total State basis, not agency basis.

6. EMPLOYEE RETIREMENT SYSTEM (Continued)

The pension benefit obligation at June 30, 1989, for the State system as a whole was $1,042,198,000. The system's net assets available for benefits at cost on June 30, 1989, were $762,195,000 leaving an overall unfunded pension benefit obligation of $280,003,000. The Lottery's 1990 contribution represented approximately .17% of total June 30, 1989, contributions required of all participating entities. The Lottery is not responsible for any state system unfunded liability.

Ten-year historical trend information showing the State system's progress in accumulating sufficient assets to pay benefits when due is presented in the system's June 30, 1989, annual financial report. Only the first two years of the required 3-year trend information is available.

7. DEFERRED COMPENSATION PLAN

The Lottery's employees are eligible to participate in the State of Montana's deferred compensation plan. The State of Montana administers the plan by contractual arrangement with Nationwide Insurance.

8. CONTRACTUAL ARRANGEMENTS

Instant Tickets - The Lottery has signed agreements to purchase instant game tickets from Dittler Brother, Inc., through March 9, 1991. This contract may be terminated by the Lottery with proper notification.

Computer Hardware and Software Maintenance - The Lottery has signed an agreement for computer hardware and software maintenance from Stratus Computer, Inc. for $4,433 per month.

On-line vender - The Lottery has signed a contract with control Data Corporation to provide on-line terminals, central computers, and telecommunication network through November 9, 1994. The contract provides for payments to be based on a percentage of weekly sales.

9. PRIZE CONTINGENCIES

Certain Big Spin prizes awarded are payable to the winners in annual installments of 17 to 20 years, with the first payment being made by the Lottery. The Lottery has entered into agreements with an insurance company under which purchased annuities will provide payments corresponding to the Lottery's obligation to these prize winners. Because it is the intent of the Lottery that the insurance company will make future installment payments directly to each prize winner, neither the present value of the annuities nor the present value of future payments are reflected in the accompanying financial statements. The Lottery would be liable for such future payments in the amount of $4,240,735 if the insurance company was to default on their payments.